Supreme Court, U.S.
FILED
MAR 14 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-963

In the Supreme Court of the United States

OCTOBER TERM, 1987

ROBERT L. HERNANDEZ, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT

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QUESTIONS PRESENTED

1. Whether a payment to the Church of Scientology for auditing or training sessions is deductible from taxable income as a "contribution or gift" under Section 170 of the Internal Revenue Code.

2. Whether the First Amendment requires that such a payment be deductible from taxable income.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-28a) is reported at 819 F.2d 1212. The decision and order of the Tax Court (Pet. App. 43a) is unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 29a) was entered on June 1, 1987. A petition for rehearing was denied on July 15, 1987 (Pet. App. 30a). On October 6, 1987, Justice Brennan extended the time within which to file a petition for a writ of certiorari to and including December 12, 1987, and the petition was filed on December 11, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner paid $7,338 to a branch of the Church of Scientology in 1981 and claimed that payment as a charitable deduction on his federal income tax return under Section 170 of the Internal Revenue Code,[1] which permits a deduction for a "contribution or gift" to certain eligible donees (see I.R.C. § 170(c)). On audit, the Commissioner disallowed that deduction and determined a tax deficiency of $2,245 (Pet. App. 1a-2a). Petitioner filed a petition in the Tax Court for review of the Commissioner's determination. There was no trial in the Tax Court, however, nor any other evidentiary submission. Instead, the parties entered into a stipulation to be bound by "any relevant findings of fact or conclusions of law" (excluding those relating to "subjective intent") to be made by the Tax Court in three consolidated "test cases" that were to be tried. The stipulation further provided that the record in the test cases, "to the extent relevant," would be deemed part of the record in this case for the purpose of appeal. See Pet. App. 3a, 44a-45a.[2] After the Tax Court decided the "test cases" in favor of the Commissioner (*Graham* v. *Commissioner*, 83 T.C. 575 (1984), aff'd, 822 F.2d 844 (9th Cir. 1987), *reprinted in* Pet. App. 31a-41a), the court entered a decision and order in the instant case "on the authority of *Graham*," finding a deficiency of $2,245 (Pet. App. 43a).

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code (26 U.S.C.), as amended (the Code or I.R.C.).

[2] The government entered into the same stipulation with numerous other taxpayers who had filed petitions in the Tax Court challenging the denial of a charitable deduction for payments to the Church of Scientology.

2. In the *Graham* case, the Tax Court entered findings of fact pertaining to the general operation of the Church of Scientology. Like petitioner, each taxpayer in *Graham* had made payments to a branch of the Church of Scientology[3] and had sought to deduct them on his or her income tax return as charitable contributions (Pet. App. 35a-36a). These payments were made in exchange for "auditing" and "training" services provided by the Church. Scientologists believe that auditing helps an individual to achieve a higher level of "spiritual competence." Auditing is administered in a one-to-one session by a trained Scientologist who asks the auditee questions and measures his skin responses during the answers by means of an electronic device. "Training" courses study the doctrines of Scientology and are believed to yield further spiritual benefits. See *id.* at 33a; see also *id.* at 2a nn.1 & 2.

The Church charges a "fixed donation" for training and auditing, which is almost never waived.[4] The Church "operates in a commercial manner" in providing these services (Pet. App. 35a). It promotes its services through lectures and radio and newspaper advertising. It gives a standard discount for payments made well in advance of the services to be rendered, and it issues refunds of those payments if the services ultimately are not received. *Id.* at 34a-35a.

In addition to these findings, the *Graham* decision was based on certain stipulations concerning the Church

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[3] The Church of Scientology consists both of a central branch, the "mother" Church of Scientology of California, and of numerous branches that are separate entities for tax purposes.

[4] Indeed, the Church's official policy letter states that "[p]rice cuts are forbidden under any guise" and "PROCESSING MAY NEVER BE GIVEN AWAY BY AN ORG." (Pet. App. 34a n.6). Free services are awarded only to fully contracted staff, on the condition that the staff member fulfill the terms of his contract (*ibid.*).

entered into for purposes of that litigation (see Pet. App. 46a-56a). The government did not contest that Scientology is a religion and that each Scientology organization to which the taxpayers paid money is a church within the meaning of Section 170(b)(1)(A)(i) of the Code and a tax-exempt religious organization under Section 501(c)(3) of the Code that is an eligible donee of charitable contributions under Section 170(c)(2) of the Code. Pet. App. 32a.[5]

After making these factual findings, the Tax Court in *Graham* ruled that the payments in question were not contributions, but rather were non-deductible payments made to purchase services (Pet. App. 36a-38a). The court explained that the payments "were not voluntary transfers without consideration, but were made with the expectation of receiving a commensurate benefit in return" (*id.* at 38a). The court continued (*ibid.*): "[W]here contributions are made with the expectation of receiving a benefit, and such

[5] The question of the validity of the "mother" Church's tax exemption was the subject of separate litigation in the Tax Court. The parties entered into the stipulations here in order to allow *Graham* and the other charitable contribution cases to go forward without awaiting the result of the tax exemption litigation, which would not necessarily affect the outcome of those cases. It was further stipulated in *Graham*, however, that the findings of fact in the tax exemption litigation and the record there could be incorporated in the *Graham* opinion (Pet. App. 32a). After a lengthy trial, the Tax Court ultimately held that the "mother" Church failed to qualify as an exempt organization for the years 1970-1972 because it diverted its profits to its founder and other persons, violated public policy by conspiring to impede the collection of taxes, and conducted virtually all of its activities, including auditing and training, for a commercial purpose. See *Church of Scientology* v. *Commissioner*, 83 T.C. 381, 415-423, 473-480 (1984), aff'd, 823 F.2d 1310 (9th Cir. 1987), petition for cert. pending, No. 87-1377. That determination is not necessarily controlling, however, for other tax years or for other branches of the Church.

benefit is received, the transfer is not a charitable contribution, but rather a quid pro quo." The court also rejected the contention that the denial of the deduction violated the First Amendment (*id.* at 38a-41a).

3. In the present case, the court of appeals affirmed the Tax Court's decision in the Commissioner's favor that had been entered on the authority of *Graham* (Pet. App. 1a-28a). The court stated (*id.* at 5a) that its inquiry into whether the payments were "contribution[s] or gift[s]" within the meaning of Section 170 of the Code was framed by this Court's recent analysis of that question in *United States* v. *American Bar Endowment*, 477 U.S. 105, 118 (1986): "The *sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration. The taxpayer, therefore, must at a minimum demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return." The court rejected petitioner's contention that this inquiry into whether a particular payment was a contribution or, instead, part of a quid pro quo arrangement did not apply to payments for religious services. The court stated (Pet. App. 6a): "We find no indication that Congress intended to distinguish the religious benefits sought by [petitioner] from the medical, educational, scientific, literary, or other benefits that could likewise provide the *quid* for the *quo* of a nondeductible payment to a charitable organization." Relying on the factual findings in *Graham*, the court concluded that petitioner had not demonstrated that the payments in question were in fact charitable contributions (*id.* at 8a-9a).

The court also rejected petitioner's constitutional claims (Pet. App. 9a-28a). The court held that Section 170 does not create any denominational preferences on its face (Pet. App. 9a-10a) or as applied in this case (*id.* at 10a-15a). The

court explained that the statute is neutral; "gifts to all charitable organizations are tax deductible; *quid pro quo* payments are not" (*id.* at 14a). The court also held that the denial of a deduction did not violate petitioner's right under the Free Exercise Clause to make "fixed donations" in exchange for auditing and training classes (*id.* at 15a-24a), and that petitioner had not shown that he was the victim of selective prosecution in connection with the denial of the claimed deduction (*id.* at 24a-28a).

DISCUSSION

1. While we disagree with petitioner that the court of appeals erred in affirming the denial of his claimed deduction, we agree that there exists a conflict in the circuits on the statutory question presented. Accordingly, we do not oppose the petition with respect to that question. The decision below, along with two other court of appeals decisions, conflicts with the decision of the Eighth Circuit in *Staples* v. *Commissioner*, 821 F.2d 1324 (1987), petition for cert. pending, No. 87-1382. Because of the stipulation to be bound by the findings of a test case, which was entered into by the parties in numerous cases where the taxpayers, like petitioner, are seeking to take a tax deduction for certain payments made to the Church of Scientology (see page 2, *supra*), there have now been four decisions issued by different courts of appeals that have considered the statutory question presented here on the basis of the same findings of fact. Three courts of appeals, including the court below, have held that these payments are not contributions within the meaning of Section 170 of the Code. See *Graham* v. *Commissioner*, 822 F.2d 844 (9th Cir. 1987); *Miller* v. *Commissioner*, 829 F.2d 500 (4th Cir. 1987), petition for cert. pending, No. 87-1449. But the Eighth Circuit in *Staples* has held that these payments are

deductible contributions. These conflicting holdings, if permitted to stand, will result in disparate tax treatment for similarly situated taxpayers.

The Eighth Circuit in *Staples* rested its decision on a legal proposition that was flatly rejected by the court below. The Eighth Circuit concluded that, under the stipulation, the auditing and training received in exchange for the payments made by petitioner must be viewed as "strictly religious practices" (821 F.2d at 1326, 1328). It then held that, as a matter of law, participation in such religious practices cannot be treated as "a recognizable return benefit" for purposes of determining whether a particular payment is a contribution (*ibid.*). For that reason, the court found "inapplicable" (*id.* at 1328) the analysis set forth by this Court in *United States* v. *American Bar Endowment*, 447 U.S. 105, 118 (1986), for determining whether a payment is a contribution under Section 170 of the Code (see page 5, *supra*). The broad rule advanced by the Eighth Circuit—excepting payments for religious services from the analysis applicable to all other claims for a tax-deductible contribution—cannot be squared with the decision below, which specifically rejected this proffered exception and held the *American Bar Endowment* analysis fully applicable. See Pet. App. 5a; see also *Graham*, 822 F.2d at 849 ("the deductibility of a contribution does not depend on whether the benefits received in return are secular or religious"); *Miller*, 829 F.2d at 504 ("no justification * * * for drawing a distinction between 'religious' and other services that produce intangible benefits"). Indeed, the court of appeals in *Staples* expressly acknowledged its "difference with the First Circuit" in *Hernandez* on this point (821 F.2d at 1327).

2. Because of the stipulations entered into between the taxpayers and the government in the cases presenting the

issue decided below, only the Ninth Circuit's decision in *Graham* was based on an actual record that contains findings of fact directly pertaining to the case before the court. We believe that it would be preferable for this Court to consider the statutory question presented here, if possible, in the concrete factual context that exists in *Graham*, rather than in the situation that exists in the cases, like this one, that were decided in the Tax Court on the basis of a stipulation to be bound by the findings in *Graham*. A petition for a writ of certiorari in *Graham* is due in this Court, on one extension, on March 30, 1988, and counsel for the taxpayers in that case (who is also counsel for the petitioner here) has informally advised us that he intends to file a petition by that date. We do not intend to oppose that petition. Accordingly, although we believe that resolution by this Court of the conflict in the circuits on the statutory question presented here would be appropriate, we do not urge the Court to grant plenary review in this case, but rather suggest that this case be held pending disposition of the petition to be filed in *Graham*.

3. In addition to his contention (Pet. 10-24) that the court of appeals erroneously interpreted Section 170 of the Code, petitioner briefly argues (Pet. 25-27) that the denial of his claimed deduction violates the First Amendment. This contention was correctly rejected by the court of appeals and by all the other courts of appeals that have considered it. In the absence of a conflict in the circuits, there is no reason for this Court to review this unmeritorious contention.

The thrust of petitioner's First Amendment claim appears to be the assertion that denial of his claimed deduction reflects a "denominational preference" (Pet. 25). There is no basis for this assertion. Section 170 is neutral; it permits gifts to qualifying organizations to be deducted, but

payments to such organizations that are not gifts are not deductible. The Revenue Ruling to which petitioner refers (Pet. 27) that recognizes "pew rents" and "church dues" as "ordinarily" deductible contributions was based on the conclusion that "the real intent is to contribute and not to hire a seat or a pew for personal accommodation" (A.R.M. 2, 1 C.B. 150 (1919), *reprinted in* Pet. App. 57a). Petitioner has laid no factual predicate for invoking that ruling. The factual finding in *Graham* was that auditing and training payments were "not voluntary transfers," but "were made with the expectation of receiving a commensurate benefit in return" (Pet. App. 38a), and petitioner has not disputed that he was in that respect similarly situated to the *Graham* taxpayers. Nor has petitioner shown or claimed that that ruling has not been applied equally to pew or membership fees for churches of all denominations, including the Church of Scientology. Accordingly, there is no basis for concluding that the denial of petitioner's claimed deduction proceeded from any discrimination among religions that would raise First Amendment concerns. The courts have correctly rejected the constitutional claims in this case and similar cases, and there is no reason for this Court to review them. See Pet. App. 10a-28a; *Miller*, 829 F.2d at 505-506; *Graham*, 822 F.2d at 850-853.

CONCLUSION

The petition for a writ of certiorari should be disposed of as appropriate in light of the disposition of the pending petition for certiorari in *Commissioner* v. *Staples,* No. 87-1382, and the petition for a writ of certiorari to be filed from the judgment in *Graham* v. *Commissioner,* 822 F.2d 844 (9th Cir. 1987).

Respectfully submitted.

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MARCH 1988

☆ U.S. GOVERNMENT PRINTING OFFICE: 1988—202-037/60351